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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D. C. 20554

In the Matter of	)	
	)	CC Docket No. 93-251
Amendment Of Parts 32 And 64 Of The Commission's Rules To Account For Transactions Between Carriers And Their Nonregulated Affiliates	)))))	

COMMENTS OF THE NYNEX TELEPHONE COMPANIES

New York Telephone Company
and
New England Telephone and
Telegraph Company

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Dated: December 10, 1993

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SUMMARY

NYNEX will continue to be responsive to the desire of the FCC, state commissions and stakeholders to provide assurance that affiliate transactions do not harm telephone ratepayers. However, this assurance can be met without the imposition of additional, detailed and costly affiliate transaction requirements as proposed in the NPRM. The FCC's proposals are untimely and unwarranted in light of multiple factors which have sharply limited any incentive or ability of carriers to shift nonregulated costs to telephone ratepayers. As detailed below, these factors include: rigorous regulatory scrutiny of affiliate transactions, e.g. under the FCC's already strict rules in this area, and in numerous audits to examine compliance with regulatory requirements; ever-intensifying competition from regulatory initiatives, market and technological forces; and price cap/incentive regulation. In addition, NYNEX has adopted an Affiliate Transactions Policy which has limited affiliate transactions and taken extra steps to safeguard the telephone ratepayer's interests in this regard. Limited Commission resources should not be deployed in promulgating and administering detailed affiliate transaction requirements (in addition to the already comprehensive requirements under the Commission's Docket 86-111 Joint Cost Rules) which are burdensome and do not yield commensurate ratepayer benefits.

Furthermore, this docket stands in contrast with other Commission initiatives to simplify and streamline regulation.[1] At a minimum, Commission action in this docket should be deferred until after the Commission concludes its upcoming LEC price cap review proceeding.[2]

With this framework, NYNEX takes the following positions relative to the various proposals in the NPRM. The FCC should:

- not apply a market valuation requirement (as under the asset transfer rules) to the range of affiliate services -- this is the most problematical proposal in the NPRM;
- provide for reasonable specificity in the current criterion for pricing affiliate transactions at prevailing company price, i.e. "substantial" transactions with third parties;
- not impose an onerous tracing requirement in connection with chain transactions but should permit, inter alia, pricing based upon fully allocated costs within the chain (where applicable);
- make specified technical refinements to the generic rate base methodology utilized in determining fully allocated cost;

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1 E.g., CC Docket No. 92-296 (depreciation simplification).

2 Even at that time, the development of a further record would likely be required to take full account of the many changes in the telecommunications arena.

- permit return on investment in fully allocated cost to be set at 11.25%, the currently prescribed interstate rate of return, with flexibility to adopt a different rate to satisfy both federal and state regulatory requirements;

- allow for several reasonable alternative approaches to estimating and truing-up fully allocated cost;

- maintain existing cost apportionment requirements involving affiliate transactions and nonregulated activities, and not adopt any additional requirements as proposed;

- decline to impose burdensome requirements respecting the Cost Allocation Manual and audit trails;

- clarify the meaning of tariff rates to include those on file with local government regulatory agencies;

- and clarify the treatment of tax reserves with respect to the costs of transferred assets.

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COMMENTS OF THE
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I. INTRODUCTION

New England Telephone and Telegraph Company and New York Telephone Company (the NYNEX Telephone Companies or NYNEX) submit these Comments in response to the Commission's Notice of Proposed Rulemaking (NPRM) released October 20, 1993, in the above-captioned matter. The Commission states that the NPRM represents a reevaluation of its affiliate transaction rules, which set forth federal accounting requirements for transactions between carriers and nonregulated affiliates. The Commission proposes additional, onerous and costly affiliate transaction rules "to enhance [the FCC's] ability to keep carriers from imposing the costs of nonregulated activities on interstate ratepayers, and to keep ratepayers from being harmed by carrier imprudence."[3]

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3 NPRM para. 1.

The FCC also indicates that its proposals are based upon its "experience" in applying the affiliate transaction rules.[4]

II. THE NPRM'S PROPOSALS ARE UNWARRANTED IN LIGHT OF DRAMATIC CHANGES IN THE TELECOMMUNICATIONS ENVIRONMENT WHICH HAVE SIGNIFICANTLY LESSENED ANY INCENTIVE OR ABILITY OF CARRIERS TO SHIFT COSTS TO TELEPHONE RATEPAYERS

The Commission states that the purpose of the proposed rules is to tighten up its current affiliate transactions rules (adopted in 1987) in view of the Commission's experience.[5] The FCC does not give any specifics on that "experience," however. In fact, the attestation audits of carriers' Cost Allocation Manuals (CAMs), as well as the FCC's Orders on CAM revisions pursuant to CC Docket No. 86-111, have in recent years indicated the FCC's accounting controls have worked smoothly and as intended, with no significant problems.

As noted, the Commission cites prevention of cost shifting as a reason for proposing additional rules, without establishing any record that there is cost shifting, in the face of evidence (the CAM attestation audits) that there is no cost shifting. Since the current rules were adopted, the telecommunications environment has seen dramatic changes which have substantially reduced any potential for cost shifting. These changes, if anything, warrant less affiliate transactions regulation, not more. These factors include:

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4 NPRM para. 9.

5 *See* NPRM paras. 1, 9.

A. Existing Intensive Scrutiny Of Affiliate Transactions

Over the years, affiliate transactions have been an area subjected to extremely strict scrutiny by regulators, e.g. in rate proceedings, audits and accounting rules. This scrutiny makes unnecessary the adoption of even more onerous and burdensome FCC affiliate transactions rules as proposed in the NPRM.

The centerpiece of the FCC's significant scrutiny of affiliate transactions, as described in paras. 2-7 of the NPRM, is the Docket 86-111 Joint Cost affiliate transaction accounting rules. Those rules are comprehensive in both substance and in application to provide safeguards against cross-subsidization of non-regulated businesses by regulated businesses. Carriers must record transactions with non-regulated affiliates at tariff rates, prevailing company price or fully distributed costs in accordance with the criteria specified in the Report and Order of Docket 86-111. In addition, asset transfers with non-regulated affiliates, absent tariff or prevailing company price, must be recorded by the carriers at either the net book cost or fair market value whichever is more beneficial to the ratepayers. Compliance is strictly scrutinized. Each year, carriers must submit to the FCC the results of an independent attestation audit of the carrier's compliance with its CAM and Commission requirements.

In 1991, the FCC further strengthened its cost accounting controls and expanded the attestation audit to a financial audit to guard against cross-subsidy of nonregulated activities.[6] Moreover, the FCC "audits the audits." The preparation of detailed carrier spreadsheets for FCC review is part of this process.

The Commission adopted requirements:

> in addition to the panoply of existing cost accounting, reporting, and enforcement safeguards, that: (1) LECs treat enhanced services as nonregulated activities for accounting and jurisdictional separations purposes; (2) independent auditors provide the same level of assurance in audits conducted pursuant to the joint cost rules as that undertaken in a financial statement audit engagement; (3) the Common Carrier Bureau study means of achieving greater uniformity in the carriers' cost allocation manuals and, if appropriate, take steps necessary to accomplish this goal;[7] (4) carriers quantify the effects of cost allocation manual changes when such changes are submitted to the Commission; and (5) the Bureau study whether to establish a reasonable threshold for determining the materiality of errors and omissions discovered in the independent audits of carrier filings, and, if appropriate,

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6 Computer III Remand Proceedings, CC Docket No. 90-623, Order released December 20, 1991, 6 FCC Rcd 7571. That Order adopted nonstructural safeguards for the provision of enhanced services on an integrated basis with carriers' telecommunications activities. The FCC's accounting rules with respect to carriers' nonregulated activities have always been closely tied to the affiliate transaction rules; each set of rules is designed to prevent cost shifting from nonregulated activities/affiliates to carriers' regulated operations. See, e.g., Docket No. 86-111 Reconsideration Order released October 16, 1987, 2 FCC Rcd 6283, paras. 1, 109.

7 On July 1, 1993, the FCC Common Carrier Bureau released an Order setting forth detailed CAM uniformity requirements (AAD 92-42, DA 93-765). Pursuant to that Order, the LECs filed CAM changes in November 1993 to implement these requirements.

> take steps necessary to implement such a threshold.[8]

The Commission concluded that:

> our comprehensive system of cost accounting safeguards has worked well and, as strengthened above, effectively protects ratepayers against cross-subsidization by the BOCs. This system consists of five principal parts: (1) the establishment of effective accounting rules and cost allocation standards; (2) the requirement for telecommunications carriers to file cost allocation manuals reflecting the established rules and standards; (3) the requirement for audits by independent auditors of carrier cost allocations, requiring a positive opinion on whether carriers' allocations comply with their cost allocation manuals; (4) the establishment of detailed reporting requirements and the development of an automated system to store and analyze the data; and (5) the performance of on-site audits by FCC staff.[9]

Furthermore, the FCC's rules have been augmented by similar state commission regulatory rules (e.g., adopted by the NY PSC in Case 88-C-136).

In addition, as part of revenue requirement issues in rate proceedings and in other regulatory proceedings, the NYNEX Telephone Companies' affiliate transactions have been thoroughly examined. Further, our regulators routinely monitor

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8 6 FCC Rcd at para. 14. In RAO Letter 12 (DA 90-1507), the FCC Common Carrier Bureau stated that, starting with the 1990 attestation audit, the discovery of any error or omission in excess of $1 million should result in a correction of the reported results.

9 5 FCC Rcd at para. 46.

this area, issuing various interrogatories and inquiries. Voluminous information is regularly submitted to regulators. Also, NYNEX has been subjected to the following affiliated interest audits:

- Massachusetts Department of Public Utilities Affiliate Transaction Audit of New England Telephone in 1991;
- NY PSC Retrospective Affiliate Transaction Audit of New York Telephone covering 1984-1990;
- Pursuant to FCC Docket 86-111 Joint Cost rules and orders, the NYNEX Telephone Companies have undergone annual independent attestation audits covering affiliate transactions, as well as cost allocation systems and methodologies, in every year starting in 1988. Starting in 1990, the scope of the audit was significantly expanded to a full financial audit;
- NARUC Multi-State Audit Team's Investigation of Bell Communications Research, Inc. (Bellcore) -- 1984;
- FCC Audit of NYNEX Shared Services -- 1985. This audit reviewed the cost allocations of NYNEX Corporate and Service Company;
- NY PSC Audit of NYNEX Corporation and Affiliates (audit report submitted to NARUC in March 1987);
- Maine PSC Audit of Affiliate Transactions -- 1987;
- NARUC Multi-State Audit Team's Report on Bellcore -- 1989;
- FCC Audit of Affiliate Transactions Between the NYNEX Telephone Companies and NYNEX Materiel Enterprises -- December 1989;
- FCC Lobbying Audit -- 1991;
- FCC/NARUC Audit of Bellcore and its transactions with the RBOCs including the NYNEX Telephone Companies -- 1991;
- FCC Audit of NYNEX Telephone Companies' transactions with Bellcore for the period of 1984 - 1990, conducted in the fourth quarter of 1991;
- FCC Audit of Time Reporting -- 1993;

- Joint FCC/State NYNEX Affiliate Transaction Audit -- 1993.

Needless to say, these audits have entailed substantial time and effort by carriers, the FCC and state commissions. A wealth of information has been submitted to regulators. Where problems have been found, they have been corrected. Overall, the process has worked very effectively to protect ratepayer interests. Therefore, additional rules are not required.

B. Competition

Competition confronting NYNEX and other LECs has substantially intensified and continues to increase, as a result of market and technological factors and regulatory initiatives. In the face of such competition, LECs are significantly pressured to keep costs and rates down.[10]

Competition in the NYNEX region has grown very quickly.[11] Competitive access providers (CAPS) such as Metropolitan Fiber Systems (MFS) and Teleport Communications Group have become a potent force in the NYNEX region, gaining substantial shares of the markets in which they have chosen to operate.[12] The FCC's Special Access Expanded Interconnection

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10 Cf. NPRM para. 101 regarding AT&T.

11 See Matter of Petition For Declaratory Ruling And Related Waivers To Establish A New Regulatory Model For The Ameritech Region, Comments of the NYNEX Telephone Companies filed with the FCC on June 11, 1993.

12 For example, CAPs are providing diverse special and switched services in the New York Metropolitan Area, consisting of: carrier point of presence (POP) to POP access transport; large businesses to POP transport,

(Footnote Continued On Next Page)

Order[13] and Switched Access Expanded Interconnection Order[14] are providing further competitive opportunities for the CAPs. Interexchange carriers (IXCs) also offer a competitive alternative to the NYNEX network. In all of these areas, price is a significant competitive factor placing all the incentives on keeping costs down rather than augmenting costs through cross subsidies. Moreover, NYNEX and the other LECs will soon face increasing competition from Cable TV and wireless providers. It has become evident that the structure of the industry is changing.[15] The recent transactions between Bell Atlantic and TCI, AT&T and McCaw, U S WEST and Time Warner, and alliances involving QVC/BellSouth and Viacom/NYNEX, provide additional evidence of a trend that will continue to place growing competitive pressure on NYNEX. To respond to these forces, NYNEX is undergoing a major transformation to a more unified region-wide structure that emphasizes cost efficiency measures.

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12 (Footnote Continued From Previous Page)

private lines networks; large business disaster recovery; facilities management services; metropolitan area Centrex-like services; local area network services; local PBX loop services; local and regional calling services; terminating long distance calling; and public telephone service.

13 CC Docket No. 91-141, Order released October 11, 1992.

14 CC Docket Nos. 91-141, 92-222, Order released October 19, 1992.

15 "NYNEX After the Wake-up Call," The New York Times, December 5, 1993, p. 5, section 3.

At a time when the very survival of some LECs is at stake because of rapidly changing technological, marketplace and competitive forces,[16] the FCC should recognize disincentives to cost-shifting and accordingly not adopt burdensome cost calculation measures that increase LEC cost burdens without commensurate ratepayer benefit.

C. Price Cap/Incentive Regulation

Since 1991, NYNEX has been subject to a new form of regulation by the FCC, i.e. price cap regulation.[17] In addition to the FCC, many states have adopted forms of price cap or incentive regulation. In essence, the FCC regulates carriers' price levels and has severed the direct link between costs and rates which existed under rate of return regulation. The FCC designed price cap regulation to foster incentives for carriers to be more efficient and productive. The carriers' prices are reduced by a productivity factor of at least 3.3%

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16 The literature is replete with accounts of the momentous changes and competitive pressures characterizing the telecommunications environment. See, e.g.: "From Sibling Rivalry To Civil War," The New York Times, November 28, 1993, p. 1, section 3 ("The risks for the Baby Bells are enormous."); "Sculpting A New Industry Sculpture," Telephony, April 19, 1993, pp. 88-97 ("No local carrier faces more competition or more demanding customers than NYNEX - which serves more Fortune 500 companies than any other RHC and is home to the nation's financial capital. And don't forget the New York PSC, arguably the most aggressive state regulatory agency when it comes to promoting local loop competition."); "Into The 'Untethered' Age," Business Week, January 11, 1993, p. 81; "Can Telephone Companies Survive Local Competition." Telephone Engineer & Management, January 1, 1993, vol. 97, issue 1, p. 13.

17 See NPRM n. 14.

each year, although the carriers may also adjust prices to reflect inflation as indicated by the Gross National Product Price Index (GNP-PI), and to reflect exogenous changes (both upward and downward) in costs. Therefore, there is an inherent incentive for NYNEX and the other LECs to cut costs to at least offset the 3.3% annual reduction due to the productivity factor.[18]

It should be emphasized that NYNEX's incentive is to be more efficient and productive and to more than offset the 3.3% productivity factor in order to realize the benefits of higher earnings levels permitted by price cap regulation. Accordingly, contrary to implications in the NPRM, we have been motivated to cut costs, not increase them.[19] One example of this motivation is the previously mentioned transformation of NYNEX's organizational structure to improve its delivery of service to customers, and to achieve more cost efficiency.

The FCC has acknowledged that price caps eliminate the motivation to cross subsidize non-regulated operations. The FCC notes that AT&T is subject to pure price cap regulation (i.e., no sharing obligations) which:

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18 The FCC's price cap system also contains a sharing mechanism whereby a carrier may retain a portion of carrier earnings above a certain level while the other portion is flowed-through to ratepayers. This provides further incentives for carriers to cut costs. For most price cap LECs (subject to a 3.3% productivity offset), there is a "50-50 sharing zone" for earnings between 12.25% and 16.25%; and return to ratepayers of 100% of earnings above 16.25%.

19 See also U.S. v. Western Electric Co., No. 91-5264, Slip Op., pp. 20-21 (D.C. Cir., May 28, 1993).

> greatly reduces the incentives that AT&T may have to shift costs between its nonregulated operations and its carrier operations. Since AT&T's price caps are unrelated to AT&T's current costs, attempts by AT&T to manipulate the costs it records for affiliate transactions will not increase AT&T's rates.[20]

The Commission goes on to observe that it has

> scheduled a review of the LECs' performance under price caps for 1994.... If we should decide in the LEC price cap review proceeding to alter the sharing mechanism, we can at that time reevaluate the appropriate extent to which the affiliate transaction rules should apply to the price cap LECs.[21]

The sound course for the FCC is to defer action in this docket until after the LEC price cap review is completed. The FCC could remove or alter the sharing mechanism; that plus the other factors indicated herein would warrant eliminating affiliate transaction rules, not imposing more burdensome affiliate transaction rules.

D. <u>NYNEX Affiliate Transactions Policy</u>

On July 22, 1991, NYNEX filed with the NY PSC a Plan For Comprehensive Restructuring Of NYNEX Corporation And Its Affiliates (the "Plan"). The Plan, which has been implemented by NYNEX and accepted by the NY PSC (in Case 91-C-0102), contains stringent rules restricting and governing affiliate

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20 NPRM para. 101.

21 NPRM para. 103.

transactions. The Plan is incorporated in the NYNEX Affiliate Transactions Policy.

The Plan essentially provides that transactions between the Telecommunications Affiliates[22] and the Non-Telephone Affiliates, other than transactions involving goods or services sold at prices constrained by regulation -- such as telephone or cellular service, are not permitted (although there are limited exceptions[23] such as, outbound services provided by the NYNEX Telephone Companies to the non-regulated affiliates). This rule covers sales into and out of the Telecommunications Affiliates. With respect to the limited exceptions, the Telecommunications Affiliates will not enter into affiliate transactions permitted under the limited exceptions prior to making a determination, in their sound business judgment, that such arrangements are to their benefit.

Accordingly, in addition to complying with strict affiliate transaction regulatory rules, the NYNEX Affiliate Transactions Policy has provided additional safeguards to satisfy the regulators' concerns.

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All these factors set forth above indicate that the existing rules and regulatory environment already provide

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22 I.e., New York Telephone, New England Telephone, Telesector Resources Group, NYNEX Science & Technology Inc., Empire City Subway, Bellcore.

23 I.e., NYNEX units other than the Telecommunications Affiliates, NYNEX Corporate and NYNEX Government Affairs.

adequate safeguards protecting telephone ratepayers from being potentially disadvantaged in affiliate transactions. There is no need to enact additional, more cumbersome, costly rules as proposed in the NPRM. The additional cost of compliance with the NPRM's proposals would more than offset any potential benefits to the ratepayers. As described in more detail below, many of the specific proposals in the NPRM are unnecessary to achieve the FCC's objectives and fall too far on the side of the spectrum of costly, burdensome regulation to be in the public interest.

III. THE FCC SHOULD REJECT ADDITIONAL RULES PROPOSED IN THE NPRM, AND MAKE SEVERAL CLARIFICATIONS

A. Market Valuation Of Affiliate Services

1. FCC Proposal

The FCC proposes to require market valuation of all affiliate services, and to apply the asymmetrical asset transfer valuation rules to such services:

> we should require carriers to record all non-tariffed affiliate transactions for which we do not permit prevailing company pricing at the higher of cost and estimated fair market value when the carrier is the seller, and at the lower of cost and estimated fair market value when the carrier is the purchaser.[24]

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24 NPRM para. 24.

The Commission invites comment on this and other departures from cost-based valuation in the required carrier accounting for affiliate transactions.[25] Furthermore, the Commission:

> propose[s] to require carriers to attempt in good faith to determine whether fair market value exceeds cost when they provide assets or services to nonregulated affiliates and whether cost exceeds fair market value when they receive assets or services from nonregulated affiliates. If these attempts indicate that assets or services should be recorded at fair market value, we propose to require carriers to make additional efforts to define that value....
>
> [I]f companies making certain kinds of purchases routinely solicit competitive bids, survey potential suppliers or obtain independent appraisals, we may require carriers to adopt identical procedures.[26]

The FCC asserts, without citing evidence, that its recommendations are needed because "instead of motivating carriers to operate efficiently, the present valuation methods for affiliate services reward imprudent carrier conduct."[27] Also, the Commission states that "developments since adoption of the affiliate transactions rules" have undermined the rationale for treating services differently than assets, i.e. to preserve the incentive for certain service activities to be provided in an efficient manner.[28]

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25 NPRM para. 12.

26 NPRM paras. 90-91.

27 NPRM para. 32.

28 NPRM para. 31.

2. NYNEX Position

NYNEX strongly opposes the use of the purported "fair market value" methodology proposed by the FCC for services. For the reasons stated herein, such application would be exceedingly costly, burdensome and against the public interest.

At the outset, the Commission does not specify the "developments" that supposedly warrant drastic changes to the affiliate transaction rules. The only developments cited by the Commission in this connection are "price cap regulatory programs that give AT&T and most large LECs efficiency incentives far stronger than those the valuation methods for affiliate services sought to preserve."[29] Such developments cut against the Commission's point. As discussed, price cap regulation has strengthened carriers' incentives to cut costs and has thereby lessened any need for additions to the affiliate transaction rules.

Although NYNEX thinks that the present valuation method for asset transfers is unbalanced, we are not seeking to change that rule here. For NYNEX, fair market value of assets can generally be obtained through formal or informal appraisals. Fair market value for services, however, presents an extremely difficult problem and one where the costs far outweigh the benefits as explained *infra*.

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29 NPRM para. 31.

The Commission's longstanding distinction for recording affiliate transactions between assets and services[30] has a very sound basis that still applies. First, as noted by the Commission,[31] parties have previously indicated that many services are most efficiently provided on a centralized basis. Thus, affiliates are specifically set up to provide these centralized services. In its transformation into a more unified region-wide enterprise, NYNEX will be consolidating more services to realize more cost efficiency. By imposing such burdensome valuation rules for affiliate services, the Commission would discourage such efficiency gains that may be passed on to the ratepayers.

Second, the fair market value of services cannot be readily ascertained nor can it be ascertained with any degree of certainty. Fair market value is generally not a specific amount, but a range of amounts to differentiate quality, packaging of additional value-added services as part of the same service, and other such factors. For example, to take a non complex service such as cleaning, there may be one rate for "light" cleaning and one for "heavy" cleaning but there may also be a wide range of rates for "heavy" cleaning based on such factors as the range of items to be cleaned, the guarantee, the level of insurance (bonding, no bond) etc. The valuation calculus becomes even more complex. In contrast to

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30 See FCC Docket 86-111, Order released February 6, 1987, paras. 294-96; Docket 86-111 Reconsideration Order released October 16, 1987, para. 91.

31 NPRM para. 31.

the variable and sometimes inchoate nature of services, assets are tangible items that can usually be valued via appraisals, surveys and other reasonable methods, although even there intangibles play a significant function in valuation.[32] Notably, the definition of "fair market value" in Black's Law Dictionary speaks of "property" and "assets."[33]

Moreover, the Commission has previously rejected applying a fair market valuation requirement to affiliate services:

> Several parties have argued that if a tariff or prevailing price is unavailable as a measure of value, we should look to the value of similar services in the marketplace. We believe that such a valuation standard is fraught with the potential for abuse, and would be difficult to monitor. In contrast, by requiring carriers and their affiliates to allocate costs pursuant to the cost allocation standards, we can ensure that an auditable measure of the cost of the service is available.[34]

The Commission's observations that fair market valuation for services is difficult to monitor, and that cost allocation standards provide an auditable measure are still valid today. The Commission provides no basis in the NPRM for altering this view and thus for altering this approach. In fact, our

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32 See FCC Docket 86-111 Order released February 6, 1987, 2 FCC Rcd 1298, n. 469.

33 Black's Law Dictionary, Henry Campbell Black, Fifth Edition, 1979.

34 Docket 86-111. Reconsideration Order released October 16, 1987, para. 131.

experience in seeking valuations in the asset area reinforces the Commission's earlier opinion.

Applying the proposed valuation methods to services would create unnecessary, costly burdens to determine what to book as "costs" for services provided by affiliates even for NYNEX with its stringent Affiliate Transactions Policy.[35] The Commission has become very well acquainted with this plethora of functions and services in the audit process. The requirement that an artificial value be estimated or determined for these services would impose a cumbersome burden with no clear benefit to the ratepayers. Its only purpose would be to provide the Commission staff with what it perceives as a better monitoring device (which in fact is not better because it is imprecise and not determinable with any degree of certainty in most instances). Such burden would increase dramatically the costs of providing the services, which would more than offset any savings, thereby defeating the purpose of increasing cost efficiency through centralization. Further, market valuation is simply inapplicable to corporate governance and ownership functions. Therefore, the Commission should maintain its previous position as stated in Paragraph 131 of the

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35 This is because the NYNEX Affiliate Transaction Policy recognizes the inherent cost efficiency benefits of centralizing support functions to the regulated NYNEX Telephone Companies, and therefore their ratepayers. It treats affiliates that are established primarily to support the NYNEX Telephone companies as part of the telecommunications group and does not prohibit transactions. Further, the Policy also recognizes that certain corporate governance, ownership and support functions must be provided by the holding company.

Reconsideration Order of Docket 86-111 released October 16, 1987, and reject the adoption of this method for affiliate services.

The Commission's proposal would impose an unnecessary burden of estimating fair market value for all the services between carriers and their affiliates (absent a tariff rate or prevailing company price), the provision of which is for the benefit of the carriers. The vague standard offered in the NPRM for estimating fair market value would necessitate the LECs allocating resources solely for the purpose of determining a regulatory "price" to book for the numerous services provided for their benefit. Typically, an outside consultant would need to be engaged to study the functions involved. The consultant would group related functions that comprise more general service functions; study those functions to understand all their aspects; try to identify comparable offerings in the marketplace;[36] and try to appraise such offerings. It is estimated that such a process would cost an average of $35,000 to $45,000[37] in external costs to evaluate each individual service function. More complicated services may require more time to analyze and compare and may cost more. Currently, the

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36 Absent any comparable offerings, the consultant might determine the "reproduction cost" of the affiliate service as a surrogate for fair market value. However, reproduction cost would likely exceed fully allocated cost, and thereby not justify the costs of the valuation exercise.

37 This is based on current experience with valuation of technology product transfers under the Technology Products Compensation Policy.

Telesector Resources Group, an affiliate established primarily to support the NYNEX Telephone Companies, provides support on 500 projects[38] to the NYNEX Telephone Companies. Each project may encompass different service functions, e.g., accounting, engineering, legal, planning, etc. Further, NYNEX Corporate provides support on 250 functions, including governance and ownership functions, to its affiliates, including the NYNEX Telephone Companies.[39] The determination of fair market value for such services would place a prohibitive cost burden on the provision of these centralized services that clearly benefit the NYNEX Telephone Companies and their ratepayers. Moreover, the proposed rules are extremely unclear as to how often this would have to be done.

NYNEX has also evaluated the cost of compliance with the proposed valuation rule through the bidding process as suggested by the Commission. In 1993, the Telesector Resources Group expended approximately $20M in securing bids and contracting for certain assets and services required by the NYNEX Telephone Companies. The preponderance of services

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38 There are 82 service categories listed in the NYNEX Cost Allocation Manual, which equates to 197 services in total representing functions performed by the NYNEX Telephone Companies for individual non-regulated affiliates, and services provided to the NYNEX Telephone Companies by the individual non-regulated affiliates. Under these broad service categories there are over 500 specific projects which may have to be valued.

39 The NPRM implies that all services can be outsourced. However, the vast majority of affiliated services, particularly those services required for corporate governance or mandated by external factors, would not be appropriate candidates for out-sourcing.